FEB
CHARLES E

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1936.

No. 500.

GUY S. MARTIN,
Petitioner,

v.

NATIONAL SURETY COMPANY, a Corporation, et al.,
Respondents.

PETITIONER'S BRIEF IN REPLY TO RESPONDENT'S BRIEF ON THE MERITS.

HAROLD R. SMALL,
418 Olive Street,
St. Louis, Missouri,
Counsel for Petitioner.

Of Counsel:
RICHARD S. BULL,
418 Olive Street,
St. Louis, Missouri.

St. Louis Law Printing Co., 415 North Eighth Street. CEntral 4477.

INDEX.

	Page
I. Summary of argument	1
II. Argument	3
Point A.—Funds not reserved when paid for completed work are freed of lien	3
Point B.—Partnership is created by agreement, not by circumstances or operation of law	8
Point C.—Fund collected by petitioner was not a trust fund	10
Point D.—Preference given for payment of past due indebtedness not a fraudulent conveyance	12
Conclusion	15

Cases Cited.

Belknap Hdw. Mfg. Co. v. Ohio River Contract Co., 271 F. 144	3
Exchange State Bank v. Federal Surety Co., 28 F. (2d) 485	3
Farmers' Bank v. Hayes, 58 F. (2d) 32	3
Glades County v. Detroit Fidelity and Surety Co., 57 F. (2d) 449	5
Gust v. Hoppe, 201 Mo. 293	14
Hale v. Hummel, 64 F. (2d) 210	13
In re M'Garry & Son, 240 F. 400	5
Lacy v. Maryland Casualty Co., 32 F. (2d) 48	4
Meehan v. Valentine, 145 U. S. 611	9
Meyer Bros. Drug Co. v. White, 165 Mo. 136	14
National Bank of Commerce v. Downie, 218 U. S. 345	7

Philadelphia Nat. Bank v. McKinley, 72 F. (2d) 89... 6
Spofford v. Kirk, 97 U. S. 484..... 7
Wall v. Beedy, 161 Mo. 625..... 14

Statutes Cited.

31 U. S. C., Sec. 203..... 6
Rev. St. Mo. 1929, Secs. 3116-3117..... 13

Other Authorities Cited.

Gilmore on Partnership, Sec. 11, p. 31..... 10
Lindley on Partnership (9th Ed.), p. 46..... 10

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1936.

No. 500.

GUY S. MARTIN,
Petitioner,

v.

NATIONAL SURETY COMPANY, a Corporation, et al.,
Respondents.

PETITIONER'S BRIEF IN REPLY TO RESPONDENT'S BRIEF ON THE MERITS.

I.

SUMMARY OF ARGUMENT.

A.

Upon payment by the Government of funds due the contractor as progress payments for completed work, such funds were freed of any lien or equitable right such as might exist in funds reserved or retained, and such payment did not constitute a mere assignment.

B.

The circumstances urged by respondents did not by operation of law create a partnership between the contractor and petitioner. A partnership is created only by agreement.

C.

No trust for the benefit of laborers and materialmen was created in the fund collected by petitioner.

D.

The preference given to petitioner by the exercise of the power of attorney given him by the contractor did not constitute a fraudulent conveyance.

II.

ARGUMENT.

POINT A.

In the brief filed in support of the petition for writ of certiorari a terse discussion was attempted, under points A and B of the argument, the aim of which was to show that the dominant authority on the issue presented is opposed to the opinion of the Circuit Court of Appeals in this case, and that the other decisions which might be relied upon by respondents are distinguishable in fact and in principle. It is petitioner's intention at this place merely to consider briefly a few of the typical cases relied upon under points A and B of respondent's brief on the merits, which were not specifically dealt with in our original brief.

In *Belknap Hdw. Mfg. Co. v. Ohio River Contract Co.*, 271 F. 144, the fund in which equitable priorities were allowed were those collected by a *receiver* for the contractor for completion of the work. In *Exchange State Bank v. Federal Surety Co.*, 28 F. (2d) 485, the surety completed the work and, upon payment of claims, was held to have an equitable lien superior to the assignment obtained by a bank which had loaned money, *but in funds not paid over by the county to the contractor or applied by him in discharge of debts.* In *Farmers' Bank v. Hayes*, 58 F. (2d) 32, construed by respondents in their brief on the merits, at pages 25-26, as holding that the equitable lien of the surety extends not only to the reserved percentage, "but also to all other sums that have accrued under the contract," not only had the surety been obliged to arrange for the completion of the contract, *but the funds involved*

were still retained. The rule is thus limited, as shown from a portion of the opinion as quoted by appellees:

> "Whether the lien of the surety extends only to the reserved percentage under the contract, and retained by the owner, or also to sums earned under the contract, *and retained by the owner,* is a question which has frequently been raised. We think it is now settled that it extends to both." (Our emphasis.)

In *Lacy v. Maryland Casualty Co.,* 32 F. (2d) 48, also quoted by appellees at page 27, the very language of the opinion immediately following the portion quoted shows that the rule contended for does not apply to moneys already paid over, but only to those unpaid when the rights of the lien or of subrogation are sought to be enforced (l. c. 51):

> "The equity arises because of the obligation of the surety to perform the contract of the principal. Upon his performance of this contract, equity subrogates him to all rights of the obligee as against the principal. Now, the obligee, upon default of the principal, is without doubt entitled to apply all moneys *unpaid* so far as necessary to reimburse his loss. If the surety, instead of performing the contract, elects to pay damages, it can be held for no more than the amount which the obligee is compelled to pay to complete the work over and above the amount which it has on hand at the time of the principal's default, for this is all the damage that the surety sustains. But, when this happens, the surety receives the benefit of the *unpaid* current estimates as well as the retained percentages." (Our emphasis.)

The foregoing analysis demonstrates that in none of these cases were the equities of the surety or of contract creditors so elevated and enforced as to deprive another

credit of the funds already paid over and applied to the discharge of the debt due him, where such funds consisted of progress payments collected for work performed by the contractor.

Other cases cited by respondents which may be mentioned briefly as refuting rather than as supporting their contentions include:

In re P. M'Garry & Son (C. C. A. 7), 240 Fed. 400. Basing its ruling upon the principle that sums ***withheld*** under the terms of a contract constitute a reserve or security set up for the protection of a certain class of creditors, the Court treated a fund in the hands of a trustee for a bankrupt contractor as charged with the same equities "as when it was *undistributed* in the hands of the United States" (l. c. 402). The plain inference is that progress payments not withheld but paid over would, at least after such payment, be discharged of all equities in favor of any special class of creditors.

Glades County v. Detroit Fidelity & Surety Co. (C. C. A. 5), 57 Fed. (2d) 449. Cited as supporting the surety's equity of exoneration, this case also deals with funds still owing and unpaid to a contractor at the time of his becoming bankrupt. Here again the reasoning of the Court is opposed to the view that the equitable lien contended for extends to funds earned and paid and which did not comprise a part of the security, for in speaking of such security it was said (l. c. 452):

> "Such a fund is the *reserve* on a building contract • • • Prairie State Bank v. United States, though a case of subrogation, clearly indicates the status of the reserved payments as a fund for the security both of the obligee and the surety on the bond."

Philadelphia Nat. Bank v. McKinlay (U. S. C. A. for D. C.), 72 F. (2d) 89. Respondents have particularly directed the Court's attention to this case, one wherein both the contractor and the surety had become bankrupt. The decision fully supports petitioner's contentions, for it was expressly ruled, in passing upon claims to funds remaining in the Government's hands, that (l. c. 91):

> "• • • those persons who furnish labor and do work on a government project have an equitable lien on the fund, for the payment of their work and labor, *until the fund is paid to the contractor.*" (Our emphasis.)

That the distinguishing fact of completed payment, present in the instant case, is misunderstood or misinterpreted by respondents, is indicated not alone by their reliance upon such decisions as those which we have hereinbefore discussed. We refer to their insistence, at page 32, and again at page 38 of their brief on the merits, upon the importance of the provision in the contractor's application for bond to the effect:

> "that the applicant had not assigned and would not assign his payment on this contract or any part thereof" (R. 89).

It may be mentioned in passing that an *assignment* to Martin of payments to become due under the contract would have been void because of the provisions of 31 U. S. C., sec. 203. The Circuit Court of Appeals correctly ruled that by virtue of these provisions the surety had no valid assignment of the progress payments collected by Martin (R. 159), and the same ruling would, of course, apply to any other assignment by the contractor not conforming to the requirements of the statute. It is no an-

swer to argue, as do respondents, that the assignment to the surety made by the contractor in his application for bond brought no new parties into the situation. Being a voluntary assignment, it is not within the exceptions recognized in *Spofford v. Kirk*, 97 U. S. 484, and *National Bank of Commerce v. Downie*, 218 U. S. 345.

The point here, however, is that the collection by Martin of the funds due under the December and January estimates, *after their allowance*, did not constitute an assignment such as was the subject of the covenant contained in the contractor's application, nor did the power of attorney exercised by Martin. The means of collection employed were the same, in legal effect, as though the contractor himself had received payment when due and had then turned over the funds to his creditor, Martin. As in those funds there were no sums reserved as additional security for performance or for payment of claims, they were freed, when paid over by the Government, of any lien or equitable right that might have attached had they been retained. Certainly, if the contractor himself had procured their receipt and thereafter had made distribution to certain favored creditors, such distribution would not be considered an "assignment" of a payment on the contract within the meaning of the term in the bond application. (Nor could such creditors be pursued and sued, in the absence of a showing in bankruptcy of a preference.) Considering the true nature of the funds in dispute and of their collection and application, it is believed that the assertions by respondents as to the validity of assignments are beside the point. The same may be said also of those decisions, among them many cited both by petitioner and respondents, which establish the priority of a surety's claim over one based merely upon an executory or inferior assignment.

It is submitted that upon analysis of the arguments and decisions relied upon by respondents, under their points A and B, no reason and no precedent is revealed in support of the one issue as decided in the opinion below. Petitioner asserts that, for the reasons and on the precedents discussed in his original brief, that opinion is erroneous and should be reversed.

POINT B.

Approximately twelve pages of respondents' brief (pp. 44-56) are devoted to a discussion of the record and of authorities in an effort to establish the existence of a partnership between Tobin, the contractor, and Martin, who loaned him money. Apparently it is realized that the evidence shows no agreement between the two to create a partnership, for stress seems to be given to what respondents urge as circumstantial evidence. Indeed, there was no agreement whatever other than that mentioned by Tobin as an arrangement whereby, in entering upon an earlier contract, he was to borrow money from Martin and to share profits with him.

Respondents urge that the existence of a partnership is a question of fact and may be proven by circumstances, but in so doing they fail to recognize the principle that the relationship is dependent upon an agreement, which, in turn, is a matter of intention.

Conceding for the argument, therefore, the truth of Tobin's testimony and viewing all the circumstances dwelt upon by respondents at such length, there is nothing indicating any relationship other than one of creditor and debtor. Martin at no time directed operations under the contract, or assumed any control even over expendi-

tures, other than to undertake to see some bills paid. He was never held out to anyone as a partner, and at no time does it appear that credit for labor or materials was extended with an understanding that anyone other than the contractor and his surety were responsible. The case then remains squarely within the principles announced by the authorities we have previously cited.

In *Meehan v. Valentine*, 145 U. S. 611, where the effect of the agreement (there in writing) is virtually identical with that asserted here, it was said (l. c. 625):

> "Throughout the original agreement and the renewals thereof the sum of $10,000 paid by Perry to the partnership, and for which they gave him their promissory notes, is spoken of as a loan, for which the partnership was to pay him legal interest at all events, and also pay him one-tenth of the net yearly profits of the partnership business if those profits should exceed the sum of $10,000. The manifest intention of the parties as apparent upon the face of the agreements, was to create the relation of debtor and creditor, and not that of partners. Perry's demanding and receiving accounts and payments yearly was in accordance with his right as a creditor. There is nothing in the agreement itself, or in the conduct of the parties, to show that he assumed any other relation. He never exercised any control over the business. The legal effect of the instrument could not be controlled by the testimony of one of the partners to his opinion that 'it was capital he had in the business the same as ours; we owed it to him; of course, we owed it to him if we did not lose it.'"

To the foregoing need only be added a reference to the fact that the text-writers have joined this Court in its determination that while proof of an agreement to share

profits is evidence of an intention to form a partnership, yet such proof is neither conclusive nor, of itself, even sufficient on the question of intention. As said by Prof. Gilmore in his work on Partnership, Sec. 11, p. 31:

> "The case of Cox v. Hickman, as finally understood, effectually dispelled the notion that participation in profits made a partnership by operation of law as to third persons."

See, also, Lindley on Partnership (9th Ed.), p. 46.

It must be concluded that the matters urged by respondents as indicating the existence of a partnership fall far short of showing an agreement creating one. Circumstances cannot substitute for intention, and as no intention to bind themselves together as partners appears from the relationship between Tobin and Martin, such contractual status does not arise by mere operation of law.

POINT C.

It is desired to reply briefly to the contention advanced by respondents under their point E. There it is asserted that the funds collected by Martin were impressed with a trust for the benefit of laborers and materialmen, because of an agreement that such funds would be first applied to the payment of their claim.

In this connection respondents quote a single sentence from Martin's testimony to the effect that when he received authority to collect the funds Tobin had said, "there were going to be some bills to pay and he wanted me to handle the funds" (Brief, pp. 60-61), and respondents then argue:

> "Although Martin's subsequent testimony about the purpose of the power of attorney varies from the foregoing, the trial court chose to believe his admission against interest, and to disbelieve his other explanations to the effect that the power of attorney was given him to repay his loan."

We find nothing in any of the trial court's findings or conclusions to indicate that by the collection of the money Martin became a trustee for the benefit of other creditors, nor do respondents cite any authority giving that effect thereto.

Furthermore, the one bit of testimony quoted does not reveal the true situation. Immediately following the part quoted by respondents it was said by Martin (R. 99):

> "I was willing to handle the funds because I wanted my money back, and I wanted to see that the bills were paid. At that time he owed me approximately $8,200.00."

That was at a time, in December, 1932, it must be noted, when the bills outstanding, so far as either the surety or Martin knew, amounted to no more than $8,000 or $9,000, while there was approximately $16,000 owing on the job to the contractor (R. 81-83). This amply explains the feeling entertained by Martin that the funds would be sufficient to pay all claims, including his own, if he were given some control, even jointly with the surety. Continuing with the testimony, above quoted, Martin said (R. 99):

> "I think I advised Mr. Hauck (adjuster for the surety) either that I had the power of attorney or that Mr. Tobin would give it to me. I am not sure that I notified Mr. Hauck that I had received it. I did not notify him that I had sent it in to the Treasury Department; I was under no obligation to do so. I was

interested in seeing these accounts paid, and I wanted to work with the National Surety Company to that end, and so told Mr. Hauck. • • •

"I did telephone to you, Mr. Mayne, before I went to Washington in January of 1933, and said that I was ready to work with the National Surety Company provided I could have joint control of these funds with them, and you told me that was not acceptable and that you would have to proceed to enjoin the collection of these funds, and at that time I had the power of attorney. I received these estimates from Mr. Tobin for the January and December payments, which he secured from the engineer, either the day I left here for Washington or the day before. I did not know at that time that Tobin was in your office and that he told you he would secure that power of attorney for you and enter into the joint control. I did not advise you in that telephone conversation that I intended to go to Washington to get this money. I did not know at that time that I was going to Washington because I did not know that Mr. Tobin would give me the estimates. I went to Washington instead of mailing the estimates because I had considerable money at stake there; I wanted to protect myself."

With this evidence in mind, it cannot be said that a trust in the funds collected was established, or that any obligation existed in Martin other than to account for any excess over the amount of the debt owing to him.

POINT D.

In their brief on the merits, respondents advance the contention that the power of attorney under which petitioner Martin collected the funds due from the Government and applied them in payment of the contractor's indebtedness constituted a conveyance which was fraudulent and

void (Brief, Point F, pp. 60-63). Reliance is there placed upon Revised Statutes of Missouri 1929, Secs. 3116 and 3117.

This contention may be refuted by a brief reference to the facts and to decisions construing and applying the cited statutes.

It may first be noted that Martin asserted no right under the power of attorney to collect any further sums than the $10,448.10 which he received, as in his answer he renounced any claim upon the funds remaining due under the contract and conceded that such funds, constituting the deferred payment and retained percentage, were properly subject to an equitable claim and lien by the surety (R. 23).

Attention may then be directed to the undisputed evidence which was that, when Martin applied the sum received, the contractor was indebted to him in approximately the same amount. Based upon aggregate indebtedness, including items which Martin had assumed and for which he was responsible, the contractor, after application of the $10,448.10, still owed $1,482.40 to Martin (Exhibit N, R. 121-125 and R. 130). Based upon the Carlinville account alone, there was then a credit balance in favor of the contractor of $42.45 (Exhibit O, R. 125-127, and R. 130), and this amount Martin agreed he was not entitled to retain (R. 24-25).* From the evidence, the District Court found that when the work was nearing completion, the contractor "was indebted to defendant Martin in a sum in excess of $10,000.00 for money loaned" (R. 28).

In such situation the power of attorney employed by Martin to obtain payment does not, if regarded as an assignment, come under the ban of the Missouri statutes or decisions as fraudulent. As pointed out by Judge Booth, in *Hale v. Hummel* (C. C. A. 8), 64 F. (2d) 210, l. c. 212: "Under decisions of the courts of the State of Missouri,

the burden of proof is upon the party alleging a fraudulent conveyance to make out in the first instance a prima facie case." Further, it was there made clear that an antecedent debt is a sufficient consideration (l. c. 213), and the Missouri cases cited leave no room for the contention made here by respondents. Thus, in *Wall v. Reedy*, 161 Mo. 625, the state Supreme Court stated (l. c. 637):

> "It may be regarded as entirely settled in this state that a debtor may prefer one creditor over another by direct payment or transfer of property, providing the property is taken in satisfaction or assumption of a just demand, and not as a mere screen to secure the property to himself."

Also, at page 649:

> "The effect of any preference sought means, of necessity, that some other less fortunate creditor is to be hindered and delayed in the collection of his debt, and upon what principle the knowledge of that fact by the preferred creditor or the further knowledge on his part that the debtor intended that the transaction should have that effect, should operate to avoid the transaction, it is difficult to conceive. Where the right of preference, as in this state, is recognized, we cannot see how it is possible for one creditor, who gets nothing more from the debtor than sufficient to pay off, discharge or settle his just claim, to commit a fraud against the rights of other creditors, or how he can be said to have participated with the debtor in the commission of a fraud."

To the same effect see *Gust v. Hoppe*, 201 Mo. 293, l. c. 300; *Meyer Bros. Drug Co. v. White*, 165 Mo. 136, l. c. 142.

It is submitted that in the light of the foregoing there is no basis for respondents' reliance upon the principles applicable to fraudulent conveyances.

CONCLUSION.

While respondents in their brief on the merits have raised some other questions in addition to those specifically dealt with in this reply, it is considered that they either are but side issues the disposition of which is accomplished by the points made herein, or that they are completely answered by our brief filed with the petition for certiorari and in support thereof. Reference in this connection is made to the following of respondents' points: Point D, treating with the petitioner's relationship as agent for the surety, which was terminated prior to his assertion of any adverse rights and upon which such rights were in no way dependent; point G, containing assertions of fraudulent conduct on the part of Martin; and point H, under which it is argued that Martin did not "come into equity with clean hands." What was said in our original brief under points D and E, it is believed, fully serves as an answer to and refutation of those contentions.

Concurring in the apparent plea of respondents that the entire case be considered here and all issues necessary to a final determination be decided, petitioner respectfully submits that the decrees below should be reversed and that judgment or appropriate directions be given for the establishment of petitioner's rights and claim.

Respectfully submitted,

HAROLD R. SMALL,
Counsel for Petitioner.

RICHARD S. BULL,
Of Counsel.